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IN THE

Supreme Court of the United States

OCTOBER TERM, 1967

BANK OF THE SOUTHWEST NATIONAL ASSOCIATION, HOUSTON,
IN ITS CAPACITY AS TRUSTEE OF THE
MRS. DUNBAR N. CHAMBERS—COMMUNITY ONE-HALF
OF ESTATE OF DUNBAR N. CHAMBERS, TRUST,
Petitioner,

v.

ROBERT L. PHINNEY,
DISTRICT DIRECTOR OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Petitioner, Bank of the Southwest National Assocation, Houston, in its capacity as trustee of the "Mrs. Dunbar N. Chambers — Community One-Half of Estate of Dunbar N. Chambers, Trust," prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fifth Circuit entered against it on February 13, 1968, in the case of *Robert L. Phinney* v. *Ruth Kiehl Chambers and Bank of the Southwest National Association, Houston, in Its Capacity as Trustee of the Mrs. Dunbar N. Chambers — Community One-Half of Estate of Dunbar N. Chambers, Trust.*

CITATIONS TO OPINIONS BELOW

The District Court did not render an opinion; its judgment (R. 197-99), printed in Appendix B hereto, *infra* p. 20a, is reported at 19 Am. Fed. Tax R.2d 789 and 67-1 U.S. Tax Cas. ¶ 9296. The opinion of the Court of Appeals (R. 207-21), printed in Appendix B hereto, *infra* p. 7a, is reported at ..... F. 2d ....., 21 Am. Fed. Tax R.2d 651, and 68-1 U.S. Tax Cas. ¶ 9214.

JURISDICTION

The judgment of the Court of Appeals was dated and entered on February 13, 1968 (R. 222; *infra* p. 19a). No petition for rehearing was filed with the Court of Appeals. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

QUESTION PRESENTED

The primary question is whether, under section 6501,[1] the assessment of an alleged income tax deficiency against Petitioner was barred under the three-year statute of limitations or was timely under the six-year statute of limitations. The answer to such primary question depends upon whether, on the federal income tax return filed by Petitioner in its capacity as trustee of the "Mrs. Dunbar N. Chambers — Community One-Half of Estate of Dunbar N. Chambers, Trust," the alleged understatement[2] of the gain arising out of Petitioner's share of the final payment on an

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[1] In this Petition all section numbers relate to the Internal Revenue Code of 1954 (26 U.S.C.) unless otherwise indicated.

[2] The trial and appeal of this case has been restricted to the limitations question. For the purpose of deciding such question, it has been assumed that the decision in *Bath* v. *United States*, 323 F. 2d 980 (5th Cir. 1963), is correct and that, therefore, Petitioner's income was understated. However, Petitioner is of the view that the *Bath* decision is wrong and that its income was not in fact understated.

installment sale of corporate stock constitutes an omission from gross income within the meaning of section 6501 (e)(1)(A).

STATUTES AND REGULATION INVOLVED

The statutory provisions involved are sections 61, 453(d), 662(c), 1014(b)(6), 1014(c), 6501(a), and 6501(e)(1)(A) of the Internal Revenue Code of 1954, and section 275(c) of the Internal Revenue Code of 1939, 53 Stat. 86. Treasury Regulation § 1.453-9(a) (1958) is also involved. These provisions are printed in Appendix A, *infra*, p. 1a.

STATEMENT OF THE CASE

In 1954 Mrs. Chambers and her husband, Dunbar N. Chambers, sold to Mr. Frank Sharp at a profit certain shares of the capital stock of High Point Realty Company which they owned as community property. Mr. Sharp gave them a cash down payment and a promissory note to evidence the balance of the consideration (R. 43-44). On their joint income tax return for 1954, the Chambers reported the sale and the income therefrom on the installment method in accordance with section 453 (R. 44).

On October 27, 1956, Mr. Chambers died and, under his will, Petitioner became his executor. Since there were debts against the community estate of Mr. and Mrs. Chambers, Petitioner as trustee also took possession of Mrs. Chambers' one-half interest in the community property (R. 117).

On the date of Mr. Chambers' death, the unpaid balance of Mr. Sharp's note was $795,957.73, which was its fair market value. Mr. Chambers' community one-half interest in such note, $397,978.87, was included in his gross estate for federal estate tax purposes, and its value was accepted and approved by the Government[3] (R. 117-18). After some

[3] For convenience, Respondent will sometimes be referred to as the "District Director" or the "Government."

further payments were made, the note's principal balance of $751,472.13 was satisfied on April 11, 1958, by the payment of $541,472.13 in cash and real estate with a fair market value of $210,000.00 (R. 34-35).

For the fiscal year ended September 30, 1958, Petitioner filed a U. S. Fiduciary Income Tax Return, Form 1041, for the decedent's estate. Petitioner reported on Schedule D of such return $318,904.77 as the gain resulting from the decedent's one-half share of the $751,472.13 final payment on the sale of the High Point Realty Company stock (R. 131). On a schedule attached to and supporting Schedule D of such return, Petitioner reported the receipt of $375,736.07 (representing the decedent's one-half share of the final payment), the percentage of such amount which constituted gain, and the amount of gain to be reported (R. 139).

Likewise, for the fiscal year ended September 30, 1958, Petitioner on or about March 15, 1959, filed a U. S. Fiduciary Income Tax Return, Form 1041, in its capacity as trustee for Mrs. Chambers' one-half interest in the community property (hereinafter referred to as the "trust return"). On Schedule D of the trust return Petitioner reported a lump sum as the amount of gain resulting from sales of stock. On a schedule attached to and supporting Schedule D of the trust return, Petitioner reported under the heading "Sale of Stock" the other one-half of the final receipt in respect of the sale of the High Point Realty Company stock as follows:

Description	Date Acquired	Sold	Price	Basis	Gain or (Loss)
High Point Realty Stock	10-27-56	1958	$375,736.06	$375,736.06	–0–

The basis claimed of $375,736.06 represented the fair market value of one-half of Mr. Sharp's note at the date

of the decedent's death, less payments received subsequent to his death (R. 118-19, 193-94). Such fair-market-value basis was claimed pursuant to Petitioner's belief that under section 1014(b)(6), a surviving wife in Texas obtained a stepped-up basis in her community one-half of a promissory note upon the death of her husband.

The net income reported on the trust return filed by Petitioner for the fiscal year ended September 30, 1958, totaled $5,676.14, all of which was long-term capital gain; such net income was shown on Schedule C of the return to have been distributed to Mrs. Chambers as the sole beneficiary of the trust (R. 185-96). For calendar 1958, Mrs. Chambers filed a U. S. Individual Income Tax Return, Form 1040, and reported the amount of $5,676.14 as capital gain in Schedule D of such return on the line provided for "[illegible]t long-term gain (or loss) from partnerships and fiduciaries." In other words, Mrs. Chambers included in her 1958 individual gross income the amounts distributed to her from the trust during its fiscal year ending within her calendar year in accordance with section 662(c) of the 1954 Code (R. 45-46, 82-83, 86).

More than three years after Petitioner and Mrs. Chambers had filed their 1958 returns, the trial court decision was handed down in *Bath* v. *United States,* 211 F. Supp. 368 (S.D. Tex. Nov. 30, 1962), *aff'd,* 323 F. 2d 980 (5th Cir. 1963), which held that although a surviving wife in Texas generally is entitled to a stepped-up basis in her one-half share of community property upon the death of her husband, she is not entitled to such step-up in the basis of a community property promissory note where the installment method of reporting was elected with respect to the sale that gave rise to the note. The *Bath* case was the first legal authority to deny such a step-up in basis. Following the decision in the *Bath* case, the District Director ex-

amined the trust return filed by Petitioner and concluded, among other things, that Mrs. Chambers' half interest in the community property note of Mr. Sharp did not acquire a basis equal to its fair market value on the date of her husband's death. Therefore, its basis did not offset the amount received, and income resulted. Pursuant to this conclusion, a statutory notice of deficiency was mailed to Petitioner on February 18, 1965, the pertinent portion of which provided that "taxable income was understated in the amount of $318,904.77 for the year ended September 30, 1958 . . ." (R. 153). Such taxable income, alleged to have arisen out of the final payment on the sale of the High Point Realty Company stock, also was inconsistently charged against Mrs. Chambers for the year 1958 under a statutory notice of deficiency dated February 18, 1965 (R. 95-98). The total assessments against Petitioner and Mrs. Chambers were paid to the Government on April 16, 1965 (R. 48, 121). Petitioner and Mrs. Chambers filed their respective claims for refund on July 29, 1965, which claims were denied by the Government on December 17, 1965 (R. 47-48, 121-22).

Upon denial of the claims for refund, Petitioner and Mrs. Chambers brought suit in the United States District Court for the Western District of Texas to recover the taxes wrongfully collected from them (R. 2-19). Accordingly, jurisdiction was conferred by 28 U.S.C. § 1340.

In the District Court Petitioner and Mrs. Chambers contended the Government's assessments were barred by the three-year period of limitations under section 6501(a). The Government admitted that only one of the taxpayers was liable for any tax owing and proceeded primarily against Mrs. Chambers. The Government urged that it was the duty of Mrs. Chambers individually rather than

Petitioner as trustee to report all of the taxable income arising out of her one-half interest in the community estate, and that the assessment against her was timely because of her failure to report in any manner the final payment of Mr. Sharp's note. Such failure was said to have resulted in an omission from her gross income of an amount properly includible therein which was in excess of 25% of the amount of gross income stated in her individual return, thereby bringing into play the six-year period of limitations under section 6501(e)(1)(A). Alternatively, the Government maintained that, even if both the trust return filed by Petitioner was proper and the assessment against Mrs. Chambers was barred by the three-year statute of limitations, the assessment against Petitioner was timely under the six-year statute of limitations because in its reporting Petitioner had omitted from gross income an amount properly includible therein which was in excess of 25% of the amount of gross income stated in the trust return. The District Court rendered summary judgment in favor of both Petitioner and Mrs. Chambers on the ground that the assessments against them were barred by the three-year period of limitations prescribed by section 6501(a) of the 1954 Code (R. 197-99).

Since the Government admitted that only one of the parties was liable for any tax due, the Court of Appeals held, for the purpose of its decision, that the trust return filed by Petitioner for the fiscal year ending September 30, 1958, was proper, and affirmed the District Court's judgment in favor of Mrs. Chambers. However, the Court of Appeals reversed the District Court's judgment in favor of Petitioner on the ground that the six-year period of limitations operated to make the Government's assessment against Petitioner timely because Petitioner's overstatement of basis constituted an omission from gross income

of an amount properly includible therein which was in excess of 25% of the amount of gross income stated in its trust return. The Court of Appeals reasoned that, even if an item of gross income is reported in a return, there is an omission of gross income unless the reporting is sufficient to enable the Government by mere inspection of the return to detect any error made with respect to such item. In the Court of Appeals' view, Petitioner's reporting was not sufficient to enable the Government to detect, by inspecting the face of the return, any error made with respect to the basis claimed because of Petitioner's alleged failure to describe the nature of the item allegedly omitted as an installment sale receipt and to make a contention on the return. The Court of Appeals also reasoned that the Government's failure to challenge Petitioner's reporting before the expiration of the three-year period of limitations, when it had challenged similar reporting on the part of another taxpayer within such period, was proof that Petitioner's reporting was inadequate.

REASON FOR GRANTING WRIT

THE DECISION OF THE COURT OF APPEALS WITH RESPECT TO SECTION 6501(e)(1)(A) IS IN CONFLICT WITH AN APPLICABLE DECISION OF THIS COURT.

The question of what constituted an omission from gross income within the meaning of section 275(c), the 1939 Code predecessor of what is now section 6501(e)(1)(A), was before this Court in the case of *Colony, Inc.* v. *Commissioner*, 357 U.S. 28 (1958). This Court there held that, if an item is reported on a return, but the amount of gain reported is understated by reason of an overstatement of basis, there is no "omission" of gross income within the meaning of what is now the six-year statute of limitations. Although *Colony* involved a 1939 Code tax year, it was

decided after the enactment of the 1954 Code and the Court observed that its decision was in harmony with the 1954 Code. Contrary to *Colony,* the Court of Appeals in the instant case held that Petitioner's overstatement of basis with respect to an item of income reported on its return constituted an "omission" of gross income.

In *Colony* the taxpayer's gross receipts from a sale of property were stated on its tax return, but the gross profit from the sale was understated as a result of overstating the basis of such property. It would have been impossible to detect the taxpayer's error by merely inspecting the face of the return, and this Court in no way suggested that such detection need be possible. In light of the legislative history of the statute this Court agreed with the taxpayer that "to omit" means "to leave out or unmentioned; not to insert, include or name." With respect to such legislative history, this Court went on to state, 357 U.S. at 36-37:

> "We think that in enacting § 275(c) [the 1939 Code provision which is the predecessor of section 6501(e)(1)(A)] Congress manifested no broader purpose than to give the Commissioner *an additional two years* [*now three years*] *to investigate tax returns in cases where, because of a taxpayer's omission to report some taxable item, the Commissioner is at a special disadvantage in detecting errors. In such instances the return on its face provides no clue to the existence of the omitted item. On the other hand, when, as here, the understatement of a tax arises from an error in reporting an item disclosed on the face of the return the Commissioner is at no such disadvantage.* And this would seem to be so whether the error be one affecting 'gross income' or one, such as overstated deductions, affecting other parts of the return. To accept the Commissioner's interpretation and to impose a five-year [now six-year] limitation when such errors affect 'gross income,' but a three-year limitation when they do not, not only

> would be to read § 275(c) more broadly than is justified by the evident reason for its enactment, but also to create a patent incongruity in the tax law . . ." (Emphasis added.)

Under *Colony,* no gross income was omitted from the return filed by Petitioner. The statutory language construed in *Colony* is identical to that of section 6501(e)(1)(A). Likewise, the facts of the instant case are almost identical to those of *Colony.* No claim is made that Petitioner failed to report its share of the final payment on the sale of the High Point Realty Company stock. Instead, the deficiency was based upon the determination that gross profits were understated by reason of an overstatement of basis. Under *Colony,* an overstatement of basis simply does not constitute an "omission" of gross income. It cannot be said that Petitioner's return provided no clue on its face as to the existence of the item alleged to have been omitted. The item was reported on the face of the return, and, consequently, the Government was at no disadvantage in discovering the alleged error. Clearly, any prejudice suffered by the Government in this case resulted solely from its failure to investigate the return within three years after it was filed.

As noted previously, the statutory language construed by this Court in *Colony* is precisely the same as that now found in subparagraph (A) of section 6501(e)(1). In enacting the 1954 Code, however, Congress added clause (ii) to section 6501(e)(1)(A). This clause, section 6501(e)(1)(A)(ii), provides that:

> "(ii) In determining the amount omitted from gross income, there shall not be taken into account any amount which is omitted from gross income stated in the return if such amount is disclosed in the return, or in a statement attached to the return, in a manner

adequate to apprise the Secretary or his delegate of the nature and amount of such item."

This provision was added by Congress for the obvious purpose of limiting the applicability of the six-year statute of limitations, and in the *Colony* case, which was decided in 1958, this Court observed that its decision was in harmony with the provisions of the 1954 Code. In the instant case, however, the Court of Appeals construed the provision as imposing very stringent requirements in direct contravention of the provision's intended function as well as the clearly defined policy of the six-year statute of limitations. The proper construction of the provision is an important question of federal tax law that has not been, but should be, settled by this Court. If the Court of Appeals' interpretation is allowed to stand, one is faced with the incongruous proposition that, contrary to Congressional expectations and the *Colony* decision, the enactment of section 6501(e)(1)(A)(ii) expanded rather than contracted the operation of the six-year statute of limitations.

Meaning of Section 6501(e)(1)(A)(ii)

Section 6501(e)(1)(A)(ii) is by no means an unambiguous statute. Questions frequently arise as to what constitutes the "nature" of an item of gross income, what constitutes the "amount" of an item of gross income, and what constitutes sufficient disclosure thereof. These questions cannot be answered by a literal reading of the words of the statute. Instead, section 6501(e)(1)(A)(ii) must be construed within the context of the intended purpose of the six-year statute of limitations. As pointed out by this Court in *Colony,* the six-year statute of limitations is intended to operate where a taxpayer leaves a taxable "item" off his return; the statute's purpose is no broader than to give the Commissioner more time to investigate a return

where, because of the taxpayer's complete failure to report a taxable item, the return on its face provides no clue as to the "existence" of the omitted item, thereby placing the Commissioner at a special disadvantage in discovering such item.

In light of this overall purpose, section 6501(e)(1)(A)(ii) must be interpreted to mean that an item is not deemed to be omitted from gross income if the nature and amount of the item are disclosed in the return, or in a statement attached thereto, in such a manner as to make it reasonably possible for the Government to discover an error by inspection and investigation of the return within three years after it is filed. The Court of Appeals' conclusion that an item must be disclosed in a manner sufficient to permit the Government to detect errors merely by inspecting the face of a return is contrary to the *Colony* case and patently absurd. The function of the statute is simply to require disclosure of the existence of a taxable item so that in investigating the return the Government will suffer no special handicap in detecting errors. To require a taxpayer to disclose in his return all possible errors affecting gross income would be unrealistic, to say the least.

In the first place, a taxpayer is not bound to disclose all possible ways or the worst possible way a transaction might be taxed. Obviously, a taxpayer should not and cannot be expected to anticipate either all possible claims by the Government or all cases which will be decided during the three-year period following the filing of his return.

In the second place, the form of the tax return furnished by the Government is not geared to any such disclosure. It does not require detailed descriptions, explanations, or contentions with respect to the taxable transactions to be reported thereon, and no item on the face of a tax return

is even denominated "gross income." If, as in the instant case, a taxpayer fills in all appropriate blanks provided on an income tax return, reporting every taxable item in the gross or maximum figure called for, and arrives at an incorrect computation of the tax only by reason of a difference between him and the Government as to the legal construction to be applied to a reported receipt, the taxpayer's use in one stage of the computation of a figure different than that ultimately determined to be correct should not be deemed an "omission" of gross income.

Petitioner's Disclosure

On Petitioner's return both the nature and amount of the item in question were disclosed in a manner sufficient to enable the Government to discover the alleged error by inspection and investigation of the return within the three-year period following its filing. The nature of the item is capital gain or loss from the sale of stock[4], which gain or loss is in question solely because of the basis claimed. The amount of the item is a maximum of $375,736.06, which is the amount of the gross receipts from the transaction and the amount of stepped-up basis claimed.

Petitioner's disclosure of the nature and amount of the item occurs in the supporting schedule to Schedule D of its trust return. There is just one proper place in the printed form of the tax return provided by the Government to report and disclose a receipt from an installment sale of stock resulting in long-term capital gain or loss. That one place is in Schedule D entitled "Gains and Losses from Sales or Exchanges of Property," and more particularly on line 7 thereof under the heading "Long Term Capital Gains and Losses — Assets Held More Than 6 Months." Likewise,

[4] Genevieve B. Walker, 46 T.C. 630 (1966), *acq.*, 1967-1 Cum. Bull. 3.

Schedule D contains just one column in which to report and disclose basis.

There was not enough space on the printed form of Schedule D to fill in all the sales, and so in accordance with the routine and common practice a supporting schedule was attached and incorporated by a reference thereto on the face of Schedule D. The supporting schedule is expressly labeled "Schedule D" and uses the same column headings. The various amounts reflected on the supporting schedule tie back into the total amounts shown on Schedule D. The nature of the item as capital gain or loss from the sale of High Point Realty Company stock was plainly reflected on the supporting schedule. Likewise, the amount of the item, $375,736.06, was plainly reported on the supporting schedule.

The Court of Appeals was of the view that the nature of the item was insufficiently disclosed by Petitioner because it was reported as gross income from a sale of stock rather than from an installment sale or a payment on an installment note. The primary reason advanced for this view was Petitioner's inconsistency in reporting the final payment on the sale of the High Point Realty Company stock as between the trust return filed by Petitioner and the income tax return filed by Petitioner on behalf of Mr. Chambers' estate. On the estate's return, the executor reported one-half of the final payment, the percentage of profit under the installment method, and the taxable portion of such receipt. No stepped-up, fair-market-value basis in the installment note was claimed on the estate's return because such step-up was prohibited by the terms of section 1014(c). However, on the trust return filed by Petitioner with respect to Mrs. Chambers' one-half interest in the community property, such stepped-up, fair-market-value basis was not prohibited by section 1014(c), and, therefore, it was claimed pursuant to section 1014(b)(6).

The only possible error made by Petitioner was the amount of basis claimed on the return. Otherwise, its reporting was technically accurate. For federal tax purposes, the difference between the amount received and the basis of the installment note is considered as resulting from the sale of the property in respect of which the note was received,[5] and, accordingly, the nature of the item as long-term capital gain from the sale of High Point Realty Company stock was plainly reported. Since Petitioner contended that none of its receipt was taxable by reason of the offsetting stepped-up basis, it would have been futile to set out an additional computation and schedule showing $375,736.06 as the amount received, zero as the percentage of profit, and zero as the taxable portion. This would have added nothing to the disclosure as already made which shows the amount of the gross receipt, claims a basis equal thereto, and as a result reports no gain or loss.

Nature of the Item

Nevertheless, any lack of symmetry in the reporting on the two returns has no bearing whatever upon the sufficiency of the disclosure of the nature of the item on Petitioner's trust return. The reporting on the trust return must and does stand on its own.

Congress, in enacting section 6501(e)(1)(A)(ii), did not specify what was meant by the phrase "the nature . . . of such item." However, its choice of the word "item" rather than the word "transaction" indicates that such phrase was intended to mean "the nature of the item of gross income," or more specifically, "the nature of the item of gross income allegedly omitted from the return." According to common everyday understanding, the term "nature" means "character, kind, sort, or type."[6] Under

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[5] See Int. Rev. Code of 1954, § 453(d); Treas. Reg. § 1.453-9(a) (1958).

[6] Webster's Third New International Dictionary (1964); Webster's New Collegiate Dictionary (1961).

federal tax law, an item of gross income is characterized as being either compensation for services, or interest, or rents, or long-term capital gain, or dividends, etc. Clearly, it was disclosure of this nature or character of an item of gross income that was intended to be required by section 6501(e)(1)(A)(ii). In the instant case, the nature or character of the item of gross income allegedly omitted from Petitioner's trust return is long-term capital gain or loss from the sale of corporate stock.

The nature of the item here in question is neither an installment sale nor the satisfaction of an installment-sale note. Such a designation may be descriptive of the nature or character of the *transaction*, but it is certainly not descriptive of the receipt's nature or character as an item of gross income. There is no such category of gross income as gain or loss from an installment sale or from the satisfaction of an installment-sale note. Nowhere under section 61, which delineates various kinds of gross income, is gross income of any such nature listed, and the reason is clear. Any gain or loss resulting from a payment on an installment sale of property or the satisfaction of an installment note is considered and reportable as resulting from the sale of the property in respect of which the note was received.[7] In the instant case the property previously sold and in respect of which the note was received was High Point Realty Company stock, a capital asset, and Petitioner accurately reported the nature of the item of gross income as long-term capital gain or loss from the sale of such stock.[8]

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[7] See Int. Rev. Code of 1954, § 453(d); Snell v. Commissioner, 97 F. 2d 891 (5th Cir. 1938); Zola Klein, 42 T.C. 1000 (1965); Treas. Reg. § 1.453-9(a) (1958).

[8] Genevieve B. Walker, 46 T.C. 630 (1966), *acq.*, 1967-1 Cum. Bull. 3.

Court of Appeals' Reasoning

The Court of Appeals' reasoning that the nature of the item was insufficiently disclosed because the Government failed to challenge the item's treatment within the three-year period of limitations, even though at one point in such period it was contesting a similar transaction in the *Bath* case, is fallacious. If this reasoning is sound, then the three-year statute of limitations would rarely apply. The Court of Appeals simply assumed that the Government actually examined the return during the three-year period and that inadequate disclosure was the reason no challenge was made. This assumption has no basis either in the record or in fact. The fact of the matter is that Petitioner's reporting was sufficient to enable the Government to make the challenge here in issue, but for some unknown reason the challenge did not occur until shortly after the *Bath* case was decided. The Government might well have failed to examine Petitioner's return within the three-year period of limitations. Only a small number of the individual and fiduciary income tax returns filed each year are actually examined.[9] Since the *Bath* case was a case of first impression, it may have been a test case the decision of which prompted additional examinations. On the other hand, someone may have examined the return within the three-year period and con-

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[9] For the fiscal year ended June 30, 1959, 60,008,000 individual and fiduciary income tax returns were filed and 2,422,000 were examined. 1959 COMM'R OF INT. REV. ANN. REP. 9, 13. For the fiscal year ended June 30, 1960, 61,260,000 individual and fiduciary income tax returns were filed and 2,571,000 were examined. 1960 COMM'R OF INT. REV. ANN. REP. 27, 36. For the fiscal year ended June 30, 1961, 62,046,000 individual and fiduciary income tax returns were filed and 3,079,000 were examined. 1961 COMM'R OF INT. REV. ANN. REP. 20, 27. For the fiscal year ended June 30, 1962, 62,326,000 individual and fiduciary income tax returns were filed and 3,120,000 were examined. 1962 COMM'R OF INT. REV. ANN. REP. 22, 33.

sciously chosen not to raise the issue. Also, someone may have examined the return and determined precisely what had occurred without even realizing that any issue existed. In short, the Government's failure to challenge the item within the three-year period could have been due to any number of reasons.

CONCLUSION

For the foregoing reasons, this Petition for Writ of Certiorari should be granted.

Dated April 10, 1968.

Respectfully submitted,

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APPENDIX A

STATUTES AND REGULATIONS

Internal Revenue Code of 1954:

§ 61. Gross income defined

(a) General definition. — Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:

(1) Compensation for services, including fees, commissions, and similar items;

(2) Gross income derived from business;

(3) Gains derived from dealings in property;

(4) Interest;

(5) Rents;

(6) Royalties;

(7) Dividends;

(8) Alimony and separate maintenance payments;

(9) Annuities;

(10) Income from life insurance and endowment contracts;

(11) Pensions;

(12) Income from discharge of indebtedness;

(13) Distributive share of partnership gross income;

(14) Income in respect of a decedent; and

(15) Income from an interest in an estate or trust.

• • • •

§ 453. Installment method

* * * *

(d) Gain or loss on disposition of installment obligations.—

(1) General rule.— If an installment obligation is satisfied at other than its face value or distributed, transmitted, sold, or otherwise disposed of, gain or loss shall result to the extent of the difference between the basis of the obligation and —

(A) the amount realized, in the case of satisfaction at other than face value or a sale or exchange, or

(B) the fair market value of the obligation at the time of distribution, transmission, or disposition, in the case of the distribution, transmission, or disposition otherwise than by sale or exchange.

Any gain or loss so resulting shall be considered as resulting from the sale or exchange of the property in respect of which the installment obligation was received.

* * * *

§ 662. Inclusion of amounts in gross income of beneficiaries of estates and trusts accumulating income or distributing corpus

* * * *

(c) Different taxable years. — If the taxable year of a beneficiary is different from that of the estate or trust, the amount to be included in the gross income of the beneficiary shall be based on the distributable net income of the estate or trust and the amounts properly paid, credited, or required to be distributed to the beneficiary during any taxable year or years of the estate or trust ending within or with his taxable year.

* * * *

§ 1014. Basis of property acquired from a decedent

(a) In general. — Except as otherwise provided in this section, the basis of property in the hands of a person acquiring the property from a decedent or to whom the property passed from a decedent shall, if not sold, exchanged, or otherwise disposed of before the decedent's death by such person, be the fair market value of the property at the date of the decedent's death, or, in the case of an election under either section 2032 or section 811(j) of the Internal Revenue Code of 1939 where the decedent died after October 21, 1942, its value at the applicable valuation date prescribed by those sections.

(b) Property acquired from the decedent. — For purposes of subsection (a), the following property shall be considered to have been acquired from or to have passed from the decedent:

* * * *

(6) In the case of decedents dying after December 31, 1947, property which represents the surviving spouse's one-half share of community property held by the decedent and the surviving spouse under the community property laws of any State, Territory, or possession of the United States or any foreign country, if at least one-half of the whole of the community interest in such property was includible in determining the value of the decedent's gross estate under chapter 11 of subtitle B (section 2001 and following, relating to estate tax) or section 811 of the Internal Revenue Code of 1939;

* * * *

§ 6501. Limitation on assessment and collection

(a) General rule. — Except as otherwise provided in this section, the amount of any tax imposed by this title shall

be assessed within 3 years after the return was filed (whether or not such return was filed on or after the date prescribed) or, if the tax is payable by stamp, at any time after such tax became due and before the expiration of 3 years after the date on which any part of such tax was paid, and no proceeding in court without assessment for the collection of such tax shall be begun after the expiration of such period.

* * * *

(e) Substantial omission of items. — Except as otherwise provided in subsection (c) —

(1) Income taxes. — In the case of any tax imposed by subtitle A —

(A) General rule. — If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 percent of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 6 years after the return was filed. For purposes of this subparagraph —

(i) In the case of a trade or business, the term "gross income" means the total of the amounts received or accrued from the sale of goods or services (if such amounts are required to be shown on the return) prior to diminution by the cost of such sales or services; and

(ii) In determining the amount omitted from gross income, there shall not be taken into account any amount which is omitted from gross income stated in the return if such amount is disclosed in the return, or in a statement attached to the return, in a manner adequate to apprise the Secretary or his delegate of the nature and amount of such item.

* * * *

Internal Revenue Code of 1939:

§ 275. Period of limitation upon assessment and collection

* * * *

(c) Omission from gross income. If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 per centum of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 5 years after the return was filed. 53 Stat. 86.

* * * *

United States Treasury Regulations:

§ 1.453-9. Gain or loss on disposition of installment obligations.

(a) In general. Subject to the exceptions contained in section 453(d)(4) and paragraph (c) of this section, the entire amount of gain or loss resulting from any disposition or satisfaction of installment obligations, computed in accordance with section 453(d), is recognized in the taxable year of such disposition or satisfaction and shall be considered as resulting from the sale or exchange of the property in respect of which the installment obligation was received by the taxpayer.

* * * *

APPENDIX B

OPINIONS AND JUDGMENTS BELOW

Court of Appeals Opinion

IN THE
UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 24729

ROBERT L. PHINNEY, District Director of Internal Revenue,

Appellant,

versus

RUTH KIEHL CHAMBERS, ET AL,

Appellees.

Appeal from the United States District Court for the Western District of Texas.

(February 13, 1968.)

Before TUTTLE and GEWIN, Circuit Judges and HUNTER, District Judge.

TUTTLE, Circuit Judge: This appeal from a summary judgment awarding to the individual appellee, Mrs. Chambers, and to the corporate appellee, Bank of the Southwest National Association, Houston, purporting to act as trustee for Mrs. Chambers, separate judgments for recovery of amounts paid by each of them separately on account of income attributed by the government to Mrs. Chambers, presents the question whether the trial court correctly applied the three year statute of limitations rather than the six year statute for the assessment of income taxes against the parties.

The facts are not in dispute. In 1954, Mrs. Chambers and her husband, Dunbar N. Chambers, owned as community property certain shares of the capital stock of High Point Realty Company. On July 1, 1954, they sold this stock at a profit to Mr. Frank W. Sharpe [*sic*] of Houston, Texas, receiving a cash down payment, with the balance of the consideration being evidenced by Mr. Sharpe's [*sic*] promissory note payable on or before September 1, 1957.

On a joint income tax return for 1954, the Chambers reported the sale and reported the income therefrom on the installment method in accordance with Section 453 of the Internal Revenue Code of 1954 and the Treasury Regulations thereunder.

On October 27, 1956, Mrs. Chambers' husband died and, under his will, the bank appellee became his executor. The bank took possession of Mrs. Chambers' half interest in the community property as well, since under the Texas laws all community debts may be satisfied out of all community property.

On the date of Mr. Chambers' death, the unpaid principal of the Sharpe [*sic*] note was $795,957.73, which was its fair market value. Mr. Chambers' half interest in that note of $397,978.87 was included in the gross estate for federal estate tax purposes. Its value was not disputed and in fact was accepted by the government. After some further payments were made, the then principal balance of the note, $751,472.13 was paid and collected in full on April 11, 1958.

For the fiscal year ended September 30, 1958, the bank, on March 13, 1959, pursuant to an extension of time for filling [*sic*], filed a U.S. fiduciary income tax return, Form 1041, as executor for the decedent's estate. The bank re-

ported on Schedule D of such return, $375,736.07. This item was reported on this return in the following manner: On line 7, under Schedule D and under the heading, "Long Term Capital Gains and Losses," there was an item, "Installment sale — schedule — $318,904.77." On the attached schedule, there were listed four categories under Schedule D:

"Sale of breeding herd, —"
"Sale of stock,—"
"Contract to sell Brahman herd"
"Installment sale."

Under "Installment sale" was the following explanation:

"Sale of High Point Realty stock	
Amount collected — Fiscal year ended 9-30-58	$378,736.07 [*sic*]
"Times percent of gross profit	84.07468%
"Gain to be reported:	$318,904.79."

On the same day that the foregoing report was made, for the income taxes due by Dunbar Chambers' estate, the bank filed a return in the following designation:

"Mrs. Dunbar N. Chambers — community one-half of estate of Dunbar N. Chambers, year ended 9-30-58."

On this return there is, of course, a corresponding Schedule D "Long Term Capital Gains and Losses — Assets Held More Than Six Months." On this return, line 7 appears to be blank, although there are some figures apparently on this schedule that are illegible. There appears to be no item to correspond at that place with the entry of "Installment Sale" shown on the husband's return. However, on a separately attached schedule, marked "Schedule D" there are several categories of Schedule D items which differ in significant respects from those attached to the correspond-

ing schedule to the return filed on behalf of the estate of Dunbar N. Chambers. The items listed in this return are:

"Sale of breeding herd —

"Sale of Stock —

"Contract to sell Brahman herd — ."

There is no item "Schedule D — Installment Sale" with the explanation such as is given on the other return itemizing the amount collected during the fiscal year ended 9-30-58, together with the percent of gross profit to be attributed thereto (84.87468%) and the gain to be reported of $318,504.79. Instead, *under the heading "Sale of Stock"* the last entry was as follows:

Descr [iption]	DATE Acquired	Sold	PRICE	BASIS	GAIN OR LOSS
High Point Realty Stock	10-27-56	1958 (date of death)	$375,736.06	$375,736.06	—0—

Mrs. Chambers filed a personal United States Income Tax Return, Form 1040, for 1958. She made no report or reference to the payment of $751,472.13, or her half, on the Sharpe [*sic*] installment note.

More than three years after the returns were filed by the bank and Mrs. Chambers respectively, the government determined that Mrs. Chambers' half interest in the community property note of Sharpe [*sic*] did not acquire a basis equal to its fair market value on the date of her husband's death. Consequently, its basis did not offset the amount received, and income resulted. Since the bank had purported to file a fiduciary return for Mrs. Chambers' half of the community property and since Mrs. Chambers did not report this amount in her individual return, the government

assessed a substantial tax deficiency against the bank on the return filed by it and separately against Mrs. Chambers for failing to include the item received on the installment note in her own individual return. The government also challenged several other items of deductions on the bank's return.

The parties agree that if the three year statute of limitation applies to these returns, then the tax was not assessable and the trial court correctly decided in favor of the two plaintiffs below, the appellees here, granting the tax refunds of the amounts which each of them respectively paid in response to the assessments.

The question whether the three year statute was applicable depends upon whether the "taxpayer" omitted from the gross income stated in the return "an amount, properly includible therein which is in excess of twenty-five percent of the gross income so stated." 26 U.S.C.A. § 6012 [*sic*].

The government contends that Mrs. Chambers should have reported the tax, and her failure to do so clearly brings the six year staute into play, for there was no disclosure on her return of any information that would give a lead to this item of income. The taxpayer, on the other hand, contends that the bank, as executor of the husband's estate, was legally required to file the return and that the inclusion of the amount of income received on behalf of Mrs. Chambers and reported as a "sale of stock" acquired the date of Mr. Chambers' death, with a basis equal to the sales price, prevented the six year statute from being applied. The contention is that there was no omission of any amount of gross income and even if there was, there was an adequate disclosure "in a manner adequate to apprise

the secretary [*sic*] or his delegate of the nature and amount of such item."

The District Director claims the right to proceed under the six year statute of limitations by reason of the provision of [the] Internal Revenue Code of 1954, § 6501(e)-(1)(A) which provides as follows:

> "(A) General Rule. — If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 percent of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 6 years after the return was filed. For purposes of this subparagraph —"

The taxpayer, on the other hand, contends that since the figure given for the gross income of the taxpayer equaled the correct figure, if it had been stated with technical correctness as the payment of an installment note rather than the sale of stock, there was no omission from gross income of "an amount" at all. For this proposition, reliance is placed on *Colony, Inc.* v. *Commr.*, 357 U.S. 28. In addition, the taxpayer contends that subparagraph (ii) of Section 6501(e)(1)(A) prevents the application of the general rule stated above. Section (ii) provides as follows:

> "(ii) In determining the amount omitted from gross income, there shall not be taken into account any amount which is omitted from gross income stated in the return, if such amount is disclosed in the return, or in a statement attached to the return, in a manner adequate to apprise the Secretary or his delegate of the nature and amount of such item."

Rather than attempt to ascertain the true state of the Texas law, as it bears on the requirements of the federal taxing laws for the filing of a fiduciary return, in order to

decide whether in the circumstances here present it was the duty of Mrs. Chambers or of the executor of her husband's estate to file the income tax return for the fiscal year ending September 30, 1958, we will assume for the purpose of this opinion that it was the duty of the bank, since, in any event, the government is entitled to retain the amount of the taxes only once. We do this because it is simpler to resolve this purely federal problem in a manner that will be decisive of the litigation that [*sic*] to explore the effects here of the community property laws of Texas. For a discussion of some aspects of this problem see *Sneed* v. *Commissioner,* 220 F.2d 313 (5 Cir. 1955); *Henderson's Estate* v. *Commissioner,* 155 F.2d 310 (5 Cir. 1946); *Barbour* v. *Commissioner,* 89 F.2d 474 (5 Cir. 1937).

Much of the problem existing here arises from the fact that prior to the decision of the case of *Bath* v. *U.S.,* 211 F.Supp. 368, S.D. Tex., aff. 323 F.2d 980, 5 Cir, 1963, some community property state taxpayers were contending that in a situation such as here existed as to Mrs. Chambers, her half interest in the Sharpe [*sic*] promissory note would take a stepped-up basis at the time of her husband's death, under the provisions of § 1014(b)(6) of the Internal Revenue Code. Dealing with this proposition, the taxpayer's brief says:

> "Consistent with that belief, the taxpayers reported the transaction in question as resulting in no gain by reason of a step-up in basis, and the three year statute of limitations expired without any challenge having been made by the government to the taxpayers reporting.
>
> "After the three year period expired, the trial court decision was handed down in Bath v. U.S., 211 F.Supp. 368 (S.D. Tex., Nov. 30, 1962) aff. 323 F. 2d 980, 5 Cir., 1963.

> "The government then had [3 f.n. not copied] legal authority for the first time to deny the step up in basis, but the three year statute had run and the only way the government could get the horse back into the barn was to try to force the transaction under the six year statute."

The basic difficulty with the taxpayer's position here is that taxpayer simply didn't give the government a chance to make a "challenge" to the taxpayer's contention, because the taxpayer made no such contention on the return it filed. Although it fairly and simply reported on Mr. Dunbar Chambers' return that he had received a final payment on the installment note of which some 84% represented gain when his return was filed on March 13, 1959, it, for some reason that is not apparent, reported the income received as "trustee" for Mrs. Chambers in precisely the same amount under a *different* heading and under an *incorrect designation as of the sale of stock* acquired on 10-27-56 and sold in "1958." In point of fact, neither the trustee for Mrs. Chambers or Mrs. Chambers personally owned any High Point Realty Stock at any time after the sale to Mr. Sharpe [*sic*] in 1954. There was no sale of stock by the trustee either acting for Mrs. Chambers or as executor of the estate of her husband.

It appears that the same accounting firm, that on March 13, 1959 prepared the return filed for the bank as executor of Chambers' estate and correctly showed the collection of the Sharpe [*sic*] note under a heading separately listed on the schedule as "Schedule D — Installment Sale" and then showed the "amount collected for the fiscal year ended 9-30-58 and the computation of the percent of the amount received that represented profit then turned right around and on the return prepared for the bank to file for Mrs. Chambers' interests *on the same day* showed no such

separate item under Schedule D, but, instead, placed a similar amount of income as being received for a "sale of stock."

We consider it significant that at the very time that the government was contesting the "step-up in basis" theory of a community interest in an installment note such as Mrs. Chambers owned in the *Bath* case in another district court in Texas, this return was lying unchallenged in the files of the Internal Revenue Service.

It simply defies that the Internal Revenue Service, while contesting the right of Bath to claim a stepped-up basis in connection with a community property interest of less than $50,000 would have complacently permitted the similar claim for stepped-up basis in the Chambers estate to go unchallenged had the return filed on behalf of Mrs. Chambers disclosed what was really at issue, that is, as claimed by taxpayer, the amount received was in payment of an installment note, which, by virtue of the provisions of Section 1041(b)(6) [*sic*] of the Internal Revenue Code acquired a stepped-up basis upon the death of her husband. No better illustration could be devised to show the need for adequate disclosure as required under sub-section (ii).

The taxpayer claims that there is no need to inquire into the adequacy of the disclosure here because under the theory supported by the United States Supreme Court decision in *Colony, Inc.* v. *Commr., supra,* so long as the gross amount reported was not in error, there was no omission of "an amount" from the return at all. In light of the subsequent enactment of the 1954 Internal Revenue Code, including sub-paragraph (ii), we think the following language of the court's opinion in *Colony* should control here:

> "WE [*sic*] think that in enacting Section 275(c) [the 1939 Code provision, which is the predecessor of Section 6501(e)(1)] Congress manifested no broader purpose than to give the commissioner [*sic*] an additional 2 years [subsequently increased to 3 years] to investigate tax returns in cases where, because of a taxpayer's omission to report some taxable item, the commissioner [*sic*] is at a special disadvantage in detecting errors." 357 U.S. 32, 36.

We conclude that the enactment of subsection (ii) as part of section 6501(e)(1)(A) makes it apparent that the six year statute is intended to apply where there is either a complete omission of an *item* of *income* of the requisite amount or misstating of the nature of an item of income which places the "commissioner . . . at a special disadvantage in detecting errors."

This provision of the statute says that in determining whether "an amount" had been omitted from gross income, there shall not be taken into account any amount which is omitted if such amount is so shown on the return as to make it reasonably possible for the Secretary to detect errors. This, it seems to us, is to say that if an item of income is shown on the face of the return or an attached statement that is *not* shown in a manner sufficient to enable the secretary by reasonable inspection of the return to detect the errors then it *is* the omission of "an amount" properly includable in the return.

It seems here that there can be no substantial argument that the disclosure made by the bank's return was "adequate to apprise the Secretary or his delegate of the *nature* and amount of such item." (Emphasis added.)

It seems worth commenting on that here we do not have a novice individual taxpayer who had attempted to state an item of income, but has chosen a technically incorrect

handle to attach to it and is thus penalized for his lack of technical skill. We have, instead, a return filed for the taxpayer by the same accounting firm that had handled the taxpayer's return before Mr. Chambers' death and whose client has now alleged in its brief before us in this case that taxpayer was fully aware of the tax effects of the death of one of a community on the remaining member's ownership of a community interest in an installment note. Moreover, as already noted, the same accounting firm prepared for filing on the same day a return for the estate in which it adequately and clearly showed that income was received on the installment note as a payment as to which 84% represented taxable gain and then, on the return in question, incorrectly and improperly listed the income as if it were received for a sale of stock which had been acquired by the trustee and sold at the basis in the hands of the trustee, with, therefore, no tax owing.

While it would be simple to say that the proof that this item was not disclosed in a manner adequate to apprise the commissioner of its nature, is the fact that the commissioner did not discover the nature of this item at the very time that he was contesting the treatment of a similar amount in the Bath estate where the facts were properly disclosed, probably we cannot base our decision on that ground. We then turn to the conclusion that it would simply be a distortion of the meaning of ordinary words of common usage to hold that the reporting of this substantial income — the final payment on an installment sale as to which admittedly 84% was gain, and thus taxable during the calendar year — as a sale of stock that had been acquired by the fiduciary and sold at its basis in the hands of the fiduciary amounted to an adequate disclosure under the applicable statute. For one discussion of the meaning of paragraph (ii) see Richards, The Extended Statute of

Limitations on Assessment, 12 Tax Law Rev. 297, 316 and see *Walker* v. *Commr.*, 46 T.C. 630, 639.

We hold, therefore, that the trial court erred in applying the three year statute of limitations to the bank's return and the judgment in its favor must be REVERSED and the case REMANDED for further proceedings consistent with this opinion.

As to the judgment in favor of Mrs. Chambers, the government concedes that in the event of our determining that the bank was the proper fiduciary, a judgment in her favor is entitled to stand. The judgment in favor of Mrs. Chambers is, therefore, AFFIRMED.

REVERSED as to the Bank of the Southwest National Association, Houston, AFFIRMED as to Ruth Kiehl Chambers.

Court of Appeals Judgment

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

October Term, 1967

No. 24729

D. C. Docket No. CA 66-11-A

ROBERT L. PHINNEY, District Director of Internal Revenue,
Appellant,

versus

RUTH KIEHL CHAMBERS, ET AL.,
Appellees.

Appeal from the United States District Court for the Western District of Texas.

Before TUTTLE and GEWIN, Circuit Judges and HUNTER, District Judge.

JUDGMENT

This cause came on to be heard on the transcript of the record from the United States District Court for the Western District of Texas, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, affirmed in part and reversed in part, and that this cause be, and the same is hereby remanded to the said District Court for further proceedings consistent therewith;

It is further ordered and adjudged that the appellee, Bank of the Southwest National Association, Houston, be condemned to pay the costs of this cause in this Court for which execution may be issued out of the said District Court.

February 13, 1968

Issued as Mandate:

District Court Judgment

IN THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF TEXAS AUSTIN DIVISION

Filed Feb 2, 1967
MAXEY HART, Clerk
By Joe Steiner, Deputy

RUTH KIEHL CHAMBERS and BANK OF THE SOUTHWEST NATIONAL ASSOCIATION, HOUSTON, in its capacity as trustee of the Mrs. Dunbar N. Chambers - Community One-Half of Estate of Dunbar N. Chambers, Trust, Plaintiffs	)	CIVIL ACTION NO. 66-11-A
v.	)	
ROBERT L. PHINNEY, Defendant	)	

FINAL JUDGMENT

The above civil action, wherein Ruth Kiehl Chambers and Bank of the Southwest National Association, Houston, in its capacity as trustee of the Mrs. Dunbar N. Chambers - Community One-Half of Estate of Dunbar N. Chambers, Trust, are Plaintiffs, and Robert L. Phinney, District Director of Internal Revenue for the First Texas District, is Defendant, came on to be heard on January 23, 1967, on Plaintiffs' motion for summary judgment pursuant to Rule 56 of the Federal Rules of Civil Procedure.

It appearing to the Court from the pleadings (and exhits thereto), evidence, answers to interrogatories, admissions, affidavits, argument, briefs, and all other facts and matters considered and found by the Court that there is no genuine issue as to any material fact and that Plaintiffs

are entitled to a judgment as a matter of law for the reason that Defendant's assessments against and collections from Plaintiffs for their respective years ending in 1958 were erroneous and illegal because such assessments and collections were barred by the three-year period of limitations under section 6501(a) of the Internal Revenue Code of 1954 (26 U.S.C. § 6501(a)) and because the six-year period of limitations under section 6501(e) of the Internal Revenue Code of 1954 (26 U.S.C. § 6501(e)) did not apply in that there was no omission from gross income of an amount properly includible therein which was in excess of 25 percent of the amount of gross income stated in the return and which was not disclosed in a manner adequate to apprise Defendant of the nature and amount of such item; and for the reason that Defendant has under his own admission inconsistently taxed the same alleged item of income twice:

It is, therefore, ORDERED, ADJUDGED, and DECREED that Plaintiff Ruth Kiehl Chambers have and recover of and from Defendant judgment in the amount of $88,226.76 in principal tax, plus assessed interest in the amount of $31,776.14, or a total of $120,002.90; and that Plaintiff Bank of the Southwest National Association, Houston, in its capacity as trustee of the Mrs. Dunbar N. Chambers — Community One-Half of Estate of Dunbar N. Chambers, Trust, have and recover of and from Defendant judgment in the amount of $76,460.66 in principal tax, plus assessed penalty in the amount of $11,469.10, plus assessed interest in the amount of $28,685.32, or a total of $116,615.08.

It is further ORDERED, ADJUDGED, and DECREED that Plaintiffs have and recover of and from Defendant accrued interest on the respective amounts of such judgment from April 16, 1965, according to law.

It is further ORDERED, ADJUDGED, and DECREED that Plaintiffs have and recover of and from Defendant their costs according to law.

It is certified that Defendant acted with probable cause in the collection of the taxes herein involved.

All relief sought herein which is not expressly granted is denied.

Done this 2 day of February, 1967, at Austin, Texas.

/s/ Jack Roberts
United States District Judge

/s/ Charles W. Hall
Attorney for Plaintiffs

/s/ Leonard B. Tatar
Attorney for Defendant

APPROVED AS TO FORM:

APPENDIX C

CONFLICTING SUPREME COURT OPINION

THE COLONY, INC., *v.* COMMISSIONER OF INTERNAL REVENUE.

CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT.

No. 306. Argued April 3, 1958. — Decided June 9, 1958.

MR. JUSTICE HARLAN delivered the opinion of the Court.

The sole question in this case is whether assessments by the Commissioner of two asserted tax deficiencies were barred by the three-year statute of limitations provided in the Internal Revenue Code of 1939.

Under the 1939 Code the general statute of limitations governing the assessment of federal income tax deficiencies is fixed at three years from the date on which the taxpayer filed his return, § 275 (a), 53 Stat. 86, except in cases involving a fraudulent return or failure to file a return, where a tax may be assessed at any time. § 276 (a), 53 Stat. 87. A special five-year period of limitations is provided when a taxpayer, even though acting in good faith, "omits from gross income an amount properly includible therein which is in excess of 25 per centum of the amount of gross income stated in the return . . . ." § 275 (c), 53 Stat. 86. In either case the period of limitation may be extended by a written waiver executed by the taxpayer within the statutory or any extended period of limitation. § 276 (b), 53 Stat. 87.[1]

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[1] The pertinent provisions of the 1939 Code are:

"SEC. 275. PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION.

"Except as provided in section 276 —

"(a) GENERAL RULE.—The amount of income taxes imposed by this chapter shall be assessed within three years after the re-

The Commissioner assessed deficiencies in the taxpayer's income taxes for each of the fiscal years ending October 31, 1946, and 1947, within the extended period provided in waivers which were executed by the taxpayer more than three but less than five years after the returns were filed. There was no claim that the taxpayer had inaccurately reported its gross receipts. Instead, the deficiencies were based upon the Commissioner's determination that the taxpayer had understated the gross profits on the sales of certain lots of land for residential purposes as a result of having overstated the "basis" of such lots by erroneously including in their cost certain unallowable items of development expense. There was no claim that the returns were fraudulent.

The Tax Court sustained the Commissioner. It held that substantial portions of the development costs were properly disallowed, and that these errors by the taxpayer

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turn was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period.

"(c) OMISSION FROM GROSS INCOME.—If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 per centum of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 5 years after the return was filed.

"SEC. 276. SAME—EXCEPTIONS.

"(a) FALSE RETURN OR NO RETURN.—In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

"(b) WAIVER.—Where before the expiration of the time prescribed in section 275 for the assessment of the tax, both the Commissioner and the taxpayer have consented in writing to its assessment after such time, the tax may be assessed at any time prior to the expiration of the period agreed upon. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon."

had resulted in the understatement of the taxpayer's total gross income by 77.2% and 30.7%, respectively, of the amounts reported for the taxable years 1946 and 1947. In addition, the Tax Court held that in these circumstances the five-year period of limitation provided for in § 275 (c) was applicable. It took the view that the statutory language, "omits from gross income an amount properly includible therein," embraced not merely the omission from a return of an item of income received by or accruing to a taxpayer, but also an understatement of gross income resulting from a taxpayer's miscalculation of profits through the erroneous inclusion of an excessive item of cost. 26 T. C. 30. On the taxpayer's appeal to the Court of Appeals the only question raised was whether the three-year or the five-year statute of limitations governed the assessment of these deficiencies. Adhering to its earlier decision in *Reis* v. *Commissioner*, 142 F. 2d 900, the Court of Appeals affirmed. 244 F. 2d 75. We granted certiorari because this decision conflicted with rulings in other Courts of Appeals on the same issue,[2] and

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[2] In conflict with this case are decisions in four different Courts of Appeals. *Uptegrove Lumber Co.* v. *Commissioner*, 204 F. 2d 570 (C. A. 3d Cir.); *Deakman-Wells Co.* v. *Commissioner*, 213 F. 2d 894 (C. A. 3d Cir.); *Slaff* v. *Commissioner*, 220 F. 2d 65 (C. A. 9th Cir.); *Davis* v. *Hightower*, 230 F. 2d 549 (C. A. 5th Cir.); *Goodenow* v. *Commissioner*, 238 F. 2d 20 (C. A. 8th Cir.). The Court of Claims has also held to the contrary of the present case. *Lazarus* v. *Commissioner*, 136 Ct. Cl. 283, 142 F. Supp. 897.

Three Courts of Appeals decisions antedating *Uptegrove Lumber Co.* v. *Commissioner, supra*, provided support for the Government's construction of § 275(c). *Foster's Estate* v. *Commissioner*, 131 F. 2d 405 (C. A. 5th Cir.); *Ketcham* v. *Commissioner*, 142 F. 2d 996 (C. A. 2d Cir.); *O'Bryan* v. *Commissioner*, 148 F. 2d 456 (C. A. 9th Cir.). But neither *Foster's Estate* nor *O'Bryan* can be regarded as the controlling authority within their respective circuits in view of the more recent decisions in *Davis* v. *Hightower, supra*, and *Slaff* v. *Commissioner, supra*. *Ketcham* is distinguishable on its facts.

The Sixth Circuit has consistently maintained its current position. The Tax Court has also regularly upheld the Commissioner. *E.g., American Liberty Oil Co.* v. *Commissioner*, 1 T. C. 386; *Estate of Giggs* v. *Commissioner*, 21 T. C. 443.

because the question as to the proper scope of § 275 (c), although resolved for the future by § 6501 (e)(1)(A) of the Internal Revenue Code of 1954, p. 37, *infra,* remains one of substantial importance in the administration of the income tax laws for earlier taxable years. 355 U.S. 811.

In determining the correct interpretation of § 275 (c) we start with the critical statutory language, "omits from gross income an amount properly includible therein." The Commissioner states that the draftsman's use of the word "amount" (instead of, for example, "item") suggests a concentration on the quantitative aspect of the error — that is, whether or not gross income was understated by as much as 25%. This view is somewhat reinforced if, in reading the above-quoted phrase, one touches lightly on the word "omits" and bears down hard on the words "gross income," for where a cost item is overstated, as in the case before us, gross income is affected to the same degree as when a gross-receipt item of the same amount is completely omitted from a tax return.

On the other hand, the taxpayer contends that the Commissioner's reading fails to take full account of the word "omits," which Congress selected when it could have chosen another verb such as "reduces" or "understates," either of which would have pointed significantly in the Commissioner's direction. The taxpayer also points out that normally "statutory words are presumed to be used in their ordinary and usual sense, and with the meaning commonly attributable to them." *DeGanay* v. *Lederer,* 250 U.S. 376, 381. "Omit" is defined in Webster's New International Dictionary (2d ed. 1939) as "To leave out or unmentioned; not to insert, include, or name," and the Court of Appeals for the Sixth Circuit has elsewhere similarly defined the word. *Ewald* v. *Commissioner,* 141 F. 2d 750, 753. Relying on this definition, the taxpayer says that the statute is limited

to situations in which specific receipts or accruals of income items are *left out* of the computation of gross income. For reasons stated below we agree with the taxpayer's position.

Although we are inclined to think that the statute on its face lends itself more plausibly to the taxpayer's interpretation, it cannot be said that the language is unambiguous. In these circumstances we turn to the legislative history of § 275(c). We find in that history persuasive evidence that Congress was addressing itself to the specific situation where a taxpayer actually omitted some income receipt or accrual in his computation of gross income, and not more generally to errors in that computation arising from other causes.

Section 275(c) first appeared in the Revenue Act of 1934. 48 Stat. 680. As introduced in the House the bill simply added the gross-income provision to § 276 of the Revenue Act of 1932, 47 Stat. 169, relating to fraudulent returns and cases where no return had been filed, and carried with it no period of limitations. The intended coverage of the proposed provision was stated in a Report of a House Ways and Means Subcommittee as follows:

> "Section 276 provides for the assessment of the tax without regard to the statute of limitations in case of a failure to file a return or in case of a false or fraudulent return with intent to evade tax.
>
> "Your subcommittee is of the opinion that the limitation period on assessment should also not apply to certain cases where the taxpayer has understated his gross income on his return by a large amount, even though fraud with intent to evade tax cannot be established. It is, therefore, recommended that the statute of limitations shall not apply where the taxpayer has failed to disclose in his return an amount of gross income in excess of 25 percent of the amount of the gross income stated in the return. The Government

should not be penalized when a taxpayer is so negligent as to leave out items of such magnitude from his return." Hearings before the House Committee on Ways and Means, 73d Cong., 2d Sess. 139.

This purpose of the proposal was related to the full Committee in the following colloquy between Congressman Cooper of Tennessee, speaking for the Subcommittee, and Mr. Roswell Magill, representing the Treasury:

"Mr. Cooper. What we really had in mind was just this kind of a situation: Assume that a taxpayer left out, say, a million dollars; he just forgot it. We felt that whenever we found that he did that we ought to get the money on it, the tax on it.

"Mr. Magill. I will not argue against you on that score.

"Mr. Cooper. In other words, if a man is so negligent and so forgetful, or whatever the reason is, that he overlooks an item amounting to as much as 25 percent of his gross income, that we simply ought to have the opportunity of getting the tax on that amount of money." House Hearings, *supra,* at 149.

The full Committee revealed the same attitude in its report:

"It is not believed that taxpayers who are so negligent as to leave out of their returns items of such magnitude should be accorded the privilege of pleading the bar of the statute." H. R. Rep. No. 704, 73d Cong., 2d Sess. 35.

The Senate Finance Committee approved of the intended coverage and language of the bill, except that it believed the statute of limitations should not be kept open indefinitely in the case of an honest but negligent taxpayer. Its report stated:

". . . Your committee is in general accord with the policy expressed in this section of the House bill. However, it is believed that in the case of a taxpayer who makes an honest mistake, it would be unfair to keep the statute open indefinitely. For instance, a case might arise where a taxpayer failed to report a dividend because he was erroneously advised by the officers of the corporation that it was paid out of capital or he might report as income for one year an item of income which properly belonged in another year. Accordingly, your committee has provided for a 5-year statute in such cases." S. Rep. No. 558, 73d Cong., 2d Sess. 43-44.

Except for embodying the five-year period of limitation, § 275(c), as passed, reflects no change in the original basic objective underlying its enactment.

As rebutting these persuasive indications that Congress merely had in mind failures to report particular income receipts and accruals, and did not intend the five-year limitation to apply whenever gross income was understated, the Commissioner stresses the occasional use of the phrase "understates gross income" in the legislative materials. The force of this contention is much diluted, however, when it is observed that wherever this general language is found its intended meaning is immediately illuminated by the use of such phrases as "failed to disclose" or "to leave out" items of income. See *Uptegrove Lumber Co.* v. *Commissioner*, 204 F. 2d 570, 572.

The Commissioner also suggests that in enacting § 275 (c) Congress was primarily concerned with providing for a longer period of limitations where returns contained relatively large errors adversely affecting the Treasury, and that effect can be given this purpose only by adopting the Government's broad construction of the statute. But this theory does not persuade us. For if the mere size of the error had been the principal concern of Congress, one

might have expected to find the statute cast in terms of errors in the total tax due or in total taxable net income. We have been unable to find any solid support for the Government's theory in the legislative history. Instead, as the excerpts set out above illustrate, this history shows to our satisfaction that the Congress intended an exception to the usual three-year statute of limitations only in the restricted type of situation already described.

We think that in enacting § 275 (c) Congress manifested no broader purpose than to give the Commissioner an additional two years to investigate tax returns in cases where, because of a taxpayer's omission to report some taxable item, the Commissioner is at a special disadvantage in detecting errors. In such instances the return on its face provides no clue to the existence of the omitted item. On the other hand, when, as here, the understatement of a tax arises from an error in reporting an item disclosed on the face of the return the Commissioner is at no such disadvantage. And this would seem to be so whether the error be one affecting "gross income" or one, such as overstated deductions, affecting other parts of the return. To accept the Commissioner's interpretation and to impose a five-year limitation when such errors affect "gross income," but a three-year limitation when they do not, not only would be to read § 275 (c) more broadly than is justified by the evident reason for its enactment, but also to create a patent incongruity in the tax law. See *Uptegrove Lumber Co.* v. *Commissioner, supra,* at 573.

Finally, our construction of § 275 (c) accords with the interpretations in the more recent decisions of four different Courts of Appeals. See note 2, *supra.* The force of the reasoning in these opinions was recognized by the Court of Appeals in the present case, which indicated that it might have agreed with those courts had the matter

been *res nova* in its circuit. 244 F. 2d, at 76. And without doing more than noting the speculative debate between the parties as to whether Congress manifested an intention to clarify or to change the 1939 Code, we observe that the conclusion we reach is in harmony with the unambiguous language of § 6501 (e)(1)(A) of the Internal Revenue Code of 1954.[3]

We hold that both tax assessments before us were barred by the statute of limitations.

Reversed.

THE CHIEF JUSTICE and MR. JUSTICE BLACK would follow the interpretation consistently given § 275(c) by the Tax Court for many years and affirm the judgment of the Court of Appeals in this case. See cases cited in note 2 of the Court's opinion.

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[3] "SEC. 6501. LIMITATIONS ON ASSESSMENT AND COLLECTION.

"(e) OMISSION FROM GROSS INCOME.—Except as otherwise provided in subsection (e)—

"(1) INCOME TAXES.—In the case of any tax imposed by subtitle A—

(A) GENERAL RULE. — If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 percent of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 6 years after the return was filed. For purposes of this subparagraph—

"(i) In the case of a trade or business, the term "gross income" means the total of the amounts received or accrued from the sale of goods or services (if such amounts are required to be shown on the return) prior to diminution by the cost of such sales or services; and

"(ii) In determining the amount omitted from gross income, there shall not be taken into account any amount which is omitted from gross income stated in the return if such amount is disclosed in the return, or in a statement attached to the return, in a manner adequate to apprise the Secretary or his delegate of the nature and amount of such item." 68A Stat. 803, 804-805.

In the Supreme Court of the United States

OCTOBER TERM, 1967

No. 1313

BANK OF THE SOUTHWEST NATIONAL ASSOCIATION, HOUSTON, IN ITS CAPACITY AS TRUSTEE OF THE MRS. DUNBAR N. CHAMBERS—COMMUNITY ONE-HALF OF ESTATE OF DUNBAR N. CHAMBERS, TRUST, PETITIONER

v.

ROBERT L. PHINNEY, DISTRICT DIRECTOR OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

In 1954, Mr. and Mrs. Dunbar N. Chambers sold stock of the High Point Realty Company to Mr. Frank W. Sharp, receiving a cash down payment, with the balance evidenced by a promissory note payable on or before September 1, 1957 (Pet. 8a). Up to the time of Mr. Chambers' death on October 27, 1956, Mr. and Mrs. Chambers, on joint income tax returns, reported the installments on the note as income from an installment sale, pursuant to Section 453 of the Internal Revenue Code of 1954 and the Treasury

299-475—68

Regulations thereunder (R. 52, 65, 74; Pet. 8a).[1] In conforming to the requirement that an aliquot share of the over-all gain on the transaction be attributed to each installment, each return showed as gain approximately 84 percent of the installments received during the pertinent period.

As of Mr. Chambers' death, the unpaid principal, and the fair market value, of the Sharp note was $795,957.73. Mr. Chambers' half interest of $397,978.37 in the balance was included in his gross estate for federal estate tax purposes (Pet. 8a). Pursuant to Texas law, petitioner, the executor of the estate, took custody, as a trustee, of Mrs. Chambers' interest in the community property, which included the other half interest in the note. Petitioner, both as executor, and as trustee for Mrs. Chambers, reported on the installment method, consistent with the election made in the 1954 joint return, note payments made during the taxable year ending September 30, 1957.

The remaining balance on the note, $751,472.13, was paid in full on April 11, 1958 (R. 6, 34–35; Pet. 8a). For the fiscal year ended September 30, 1958, petitioner, as executor for the decedent's estate, filed an income tax return for the estate reporting $375,736.07, the estate's share of the final payment, on Schedule D, "Long Term Capital Gains and Losses," as "Installment sale—schedule—$318,904.77" (R. 131). The

[1] "R." references are to the printed record in the court of appeals.

attached schedule had the following elaboration under the heading "installment sale" (R. 139):

Sale of High Point Realty stock

Amount collected—fiscal year ended 9-30-58	$375,736.07
Times percent of gross profit	84.87468%
Gain to be reported	$318,904.79

On the same day petitioner, as trustee, filed a return entitled (Pet. 9a):

> Mrs. Dunbar N. Chambers—community one-half of estate of Dunbar N. Chambers, year ended 9-30-58

This return also had a Schedule D and a separately attached schedule. The schedule listed three items in the same manner as the estate's income tax return.[2] There was, however, no "Installment Sale" reported. Instead, Mrs. Chambers' interest in the final payment under the Sharp note was listed under the heading "Sale of Stock", as follows (R. 127):

Description	Date Acr'd	Date Sold	Sales Price	Basis	Gain or loss
High Point Realty Stock	10-27-56 [date of death]	1958	$375,736.06	$375,736.06	—0—

Nothing in the return indicated that this "sale" reflected receipts from the same transaction that the estate for the same year, and Mrs. Chambers or petitioner on her behalf in earlier years, had reported as an "installment sale". Mrs. Chambers, in her personal

[2] The items are (R. 127, 139):
Sale of breeding herd
Sale of Stock
Contract to sell Brahman herd

income tax return for 1958, in no manner reported the final payment.

More than three, but less than six years thereafter, the Internal Revenue Service determined that Mrs. Chambers had a gain on her half interest in the final payment on the note in the amount of $318,904.77, computed in the same manner as in previous years, consistent with installment sale reporting (R. 151–155; Pet. 9a). The Service assessed an appropriate deficiency against Mrs. Chambers, on the theory that she, rather than petitioner, was the appropriate party to report the transaction. An alternative, inconsistent deficiency was assessed against petitioner, in order to protect the revenues in the event the courts later held that petitioner was the proper reporting party. The deficiency notices were based on the assertion that neither Mrs. Chambers nor petitioner had adequately apprised the Service of the nature and amount of an item in excess of 25 percent of the gross income shown in the return, so that the extended six-year limitations period of Section 6501(e)(1)(A) of the 1954 Code applied to either of them.

Both deficiencies were paid. Petitioner and Mrs. Chambers, after claims for refund were rejected, sued for refunds in the United States District Court for the Western District of Texas (R. 2–19, 156). The District Court granted their motions for summary judgment (R. 197–199; Pet. 20a–22a). The court did not state which of the plaintiffs was the proper reporting party; it held that neither return failed to disclose an item of gross income in excess of 25 percent

of the gross income shown on the return, so that the extended limitations period did not apply to either.

The court of appeals reversed as to petitioner. Assuming, but not deciding, that petitioner was the proper reporting party, it held the six-year period applicable; the correctness of this decision is the only question presented here.

The decision below is correct. There is no conflict in decisions or other reasons warranting further review.

1. Section 6501(e)(1)(A) of the 1954 Code provides the Treasury with a six rather than a three-year period for assessing additional taxes "[i]f the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 percent of the amount of gross income stated in the return * * *." The statute further provides (Section 6501(e)(1)(A)(ii)):

> (ii) In determining the amount omitted from gross income, there shall not be taken into account any amount which is omitted from gross income stated in the return if such amount is disclosed in the return, or in a statement attached to the return, *in a manner adequate to apprise the Secretary or his delegate of the nature and amount of such item.* [Emphasis supplied.]

It is abundantly clear that the tax return petitioner filed on behalf of Mrs. Chambers was not "adequate to apprise the Secretary * * * of the nature and amount" of her half share of the final payment on the Sharp note. The most glaring defect was in petitioner's identification of the transaction as a straight sale of stock, occurring in 1958, with basis and selling

price equal and no gain reportable. The underlying transaction was, of course, the receipt in 1958 of the final payment on an installment sale of stock occurring in 1954—the earlier receipts on which had been reported as amounts 84 percent of which was long term capital gain, in accordance with the explicit requirements of the installment reporting Regulations, Section 1.453–8(b). As the court of appeals pointed out (Pet. 14a–15a), on the very same day petitioner filed the return in question it also filed a fiduciary return for the estate of Mrs. Chambers' husband. Both returns were prepared by the same accounting firm. The estate return specifically listed the other one-half of the final payment on the note as an "installment" sale receipt in accordance with the controlling statute and Regulations. As the very difference in the language of the return filed on Mrs. Chambers' behalf shows, that language put "the Commissioner * * * at a special disadvantage in detecting" the error of reporting, *Colony, Inc.* v. *Commissioner,* 357 U.S. 28, 36, the type of circumstance to which Congress intended to apply the extended limitations period.[3]

2. This case is not in conflict with *Colony, Inc.* v. *Commissioner, supra.* In *Colony,* both the amount of gross receipts and true nature of the transactions—gross receipts from certain land sales—were disclosed on the return, even though the basis of the land was

[3] Notably petitioner's return was lying unchallenged at the same time the government was challenging an identical transaction, reported as an "installment" payment, in *Bath* v. *United States,* 211 F. Supp. 368 (S.D. Texas), affirmed 323 F. 2d 980 (C.A. 5) (See Pet. 15a).

overstated. Here, on the other hand, the critical fact that the item represented receipts from the collection of a note evidencing an installment sale was not disclosed on the return, and this in turn forestalled a determination of the amount properly to be reported as gain. Thus, unlike *Colony*, the return here lacked the minimum information necessary for the Commissioner to ascertain even the proper legal rule governing the tax treatment of the transaction.

This factual difference is particularly significant in view of this Court's observation in *Colony* (357 U.S. at 37), while applying Section 275(c) of the Internal Revenue Code of 1939, that the conclusion reached was in harmony with the successor provisions of Section 6501(e)(1)(A) of the 1954 Code. The 1954 provision added Section 6501(e)(1)(A)(ii), p. 5 *supra*. As the court of appeals held (Pet. 16a), the enactment of this subsection made it apparent that the extended period applies "where there is * * * misstating of the *nature of an item* of income" which places the "commissioner * * * at a special disadvantage in detecting errors." [Emphasis supplied.] In *Colony*, the return properly identified the nature of an item of gross receipts as a "sale". Here, in contrast, the identity of "sale" given the item in question was plainly incorrect.

3. The decision in no event warrants review in this Court because the adequacy of the disclosure on petitioner's return arises against a highly unique factual background that is not likely to recur, so that a decision here is unlikely to have general importance in the administration of the tax laws.

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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